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NONCOMPETITION AGREEMENTS

The Eighth Circuit's recent decision in *Symphony Diagnostic Servs. No. 1 v. Greenbaum* upheld the enforceability of noncompetition and confidentiality agreements assigned by Ozark Mobile Imaging to Mobilex as part of Mobilex's purchase of Ozark's assets. In this Bloomberg Law Insights article, Epstein Becker & Green attorneys James Flynn, Paul Gomez, Purvi Maniar and Yael Spiewak discuss lessons for those seeking to enforce or to avoid enforcement of noncompetition and confidentiality agreements following the acquisition of a business via an asset purchase.

Assignment Lessons: Eighth Circuit Finds Assigned Non-Competes Enforceable—Under Certain Facts

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The U.S. Court of Appeals for the Eighth Circuit's recent decision in *Symphony Diagnostic Servs. No. 1 v. Greenbaum*, No. 15-2294 (8th Cir. July 6, 2016), upheld the enforceability of non-compete and confidentiality agreements assigned by Ozark Mobile Imaging to Mobilex as part of Mobilex's purchase of Ozark's assets. Although the Eighth Circuit is careful to ground its analysis in that case's specific factual and legal framework, this decision is helpful in providing some guidance to those dealing with the assignability of rights under non-compete and confidentiality agreements.

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State Laws Vary Regarding Assignability

The non-compete and confidentiality agreements at issue were (1) ''free standing'' and (2) assignment did not ''materially change the obligations of the employee'' nor (3) were the agreements dependent upon ''qualities specific to the employer.'' *Symphony Diagnostic Servs.* It is also notable that the agreements contained no language regarding assignability, *i.e.* they did not expressly restrict or permit assignment. *Symphony Diagnostic Servs. No. 1 v. Greenbaum*, 97 F. Supp. 3d 1126 (W.D. Mo. March 16, 2015). Under those factual circumstances, the Eighth Circuit, applying Missouri law, concluded that a Missouri court would find the agreements assignable and enforceable.

There are lessons for both those seeking to enforce or to avoid enforcement of non-compete and confidentiality agreements following the acquisition of a business via an asset purchase.

The first lesson is ''pay attention to state law.'' While the Eighth Circuit applying the Missouri framework is helpful, it may vary significantly by state. For example, in Ohio, courts generally construe non-compete clauses

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against the employer, and do not view non-competes as *per se* assignable. *Fitness Experience, Inc. v. TFC Fitness Equip., Inc.*, 355 F. Supp. 2d 877 (N.D. Ohio Dec. 17, 2004) (looking to factors such as contract language, protection of the employer's goodwill, and additional employee burden to determine assignability). In fact, the Ohio Court of Appeals stated that ''the employment relationship is a personal matter between an employee and the company who hired him and for whom he chose to work. Unless an employee explicitly agreed to an assignability provision, an employer may not treat him as some chattel to be conveyed, like a filing cabinet, to a successor firm.'' *Cary Corp. v. Linder*, No. 80589, 2002-Ohio-6483, 19 I.E.R. Cases 1170 (Ohio Ct. App. Nov. 27, 2002); *see also Reynolds & Reynolds v. Hardee*, 932 F. Supp. 149 (E.D. Va. July 11, 1996) (employment agreement is based on mutual trust and confidence; non-compete is not assignable). Pennsylvania also takes a dim view of the assignability of such agreements in the asset purchase context. *See Hess v. Gebhard & Co. Inc.*, 570 Pa. 148, 808 A.2d 912 (Pa. Oct. 16, 2002) (''We hold that a restrictive covenant not to compete, contained in an employment agreement, is not assignable to the purchasing entity, in the absence of a specific assignability provision, where the covenant is included in a sale of assets''). Non-compete restrictions are generally not enforceable and void in California, subject to certain exceptions including acquisition of a business that includes purchase of goodwill or sale of an ownership interest in a business, with such restrictions limited to similar businesses to the acquired business and a specific geographic area. Cal. Bus. & Prof. Code § 16601. Non-compete restrictions are generally not enforceable and void in Colorado. Colo. Rev. Stat. § 8-2-113(2). New York has also emphasized the need to determine whether the contract containing such a covenant is a personal services contract, and therefore not assignable. *Seligman & Latz, Inc. v. Noonan, 201 Misc. 96, 104 N.Y.S.2d 35* (N.Y. Sup. Ct. April 23, 1951). On the other hand, Kentucky law takes a more assignment friendly approach and generally views non-competes as assignable. *Managed Health Care Assocs. v. Kethan*, 209 F.3d 923 (6th Cir. (Ky.) March 10, 2000) (where ''the only thing that changed was the entity now entitled to enforce'' the agreement, and the contractual rights and duties of an employee remain, non-competes are assignable). New Jersey takes a similar approach, noting that ''[u]pon the sale of a business a restrictive covenant . . . is assignable without express words to that effect and passes as an incident of the business sold even though not specifically assigned'' and should ''be assignable as an incident of the business even if not made so by express words.'' *JH Renerde, Inc. v. Sims*, 312 N.J. Super. 195, 711 A.2d 410 (N.J. App. Div. Feb. 19, 1998).

Stand-Alone Agreements

Based on the Eighth Circuit's decision, another lesson for employers is that they may want to consider stand-alone non-compete or confidentiality agreements, taking care, of course, to assure that there remains valid supporting consideration under applicable law. Having the non-compete or confidentiality agreement stand alone and apart from any employment contract at issue was critical for the Eighth Circuit in distinguishing assignable agreements from personal service contracts that may not be assigned. Likewise, such employers may want to negotiate agreements that include language specifically allowing assignment to an acquirer of the business without consent of the other party, typically found in a successors and assigns clause. Use of language that precludes working in a particular field or a narrow subset within that field may make assigned rights easier to enforce than more generic references to prohibiting competition with any aspect of the employer's business, which, post sale, may have expanded greatly.

Lessons May Be Inverse

For those seeking to avoid assignability of rights under non-compete or confidentiality agreements, the lessons are inverse, save the common direction to make sure that the law of the applicable state is considered first and foremost. Challengers should review agreements to see whether they include language that prohibits assignability, or whether assignability language is absent.

They may wish to argue that where non-compete or confidentiality provisions are integrated into broader employment agreements, a personal services contract exists, which may impact on assignability under state law. Finally, they should look to whether the terms of the non-compete or confidentiality agreement are linked to the specific practice of the former employer or to the employee's particular duties, customers and territories, or are of broader scope, preventing competition against the employer's business generally.

In the latter case, it is more likely that assignment could result in a material change to the restrictions and obligations placed upon the employee where the acquiring employer's overall business varies significantly from that of the original assigning employer. Though such rights may be assignable, they are less likely to be enforceable. As noted above, any such assessments are also made in light of each state's approach to assignability of non-competes—which varies across the country.

Leveraging Aids to Enforceability

Would-be purchasers of another employer's assets can also take such lessons into account. If any of the aids to enforceability are absent from the contracts to be assigned, a purchaser or its counsel may seek to leverage such facts in negotiating price or in adjusting escrow or indemnification obligations. Conversely, a purchaser could suggest, or a seller could decide, that existing and possibly deficient agreements be amended pre-sale. Of course, in such circumstances, the amending employer must again resort to state law analysis of such terms.

In those same circumstances, one must also consider whether the amended agreement is supported by adequate consideration. Such consideration requirement can vary, depending on the state. For instance, mere continued at-will employment is sufficient consideration to support a new non-competition agreement in New Jersey under various cases. *See Martindale v. Sandvik, Inc.*, 173 N.J. 76, 800 A.2d 872 (N.J. Supreme Court July 17, 2002); *see also Quigley v. KPMG Peat Marwick, LLP*, 330 N.J. Super. 252, 749 A.2d 405 (N.J. App. Div. 2000), *certif. denied,* 165 N.J. 527, 760 A.2d 781 (N.J. Sept. 7, 2000) (stating that employment can be

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deemed consideration for employee's submission to employer's demands, including arbitration); *Hogan v. Bergen Brunswig Corp.,* 153 N.J. Super. 37, 378 A.2d 1164 (N.J. App. Div. Sep. 29, 1977) (holding that continuation of plaintiff's employment after plaintiff signed letter acknowledging restrictive covenant against post-employment competition constituted sufficient consideration to enforce agreement). But, in a state like Illinois, the continued employment must meet a certain threshold minimum time period. *See Fifield v. Premier Dealer Services, Inc.*, 2013 IL App (1st) 120327, 993 N.E.2d 938 (Ill. 1st Dist. June 24, 2013) (noting that Illinois courts have ''repeatedly held that two years of continued employment is adequate consideration to support a restrictive covenant''). Further, in other jurisdictions like Texas and Pennsylvania, there is a requirement that non-competition agreements be supported by independent consideration beyond continued employment. *See, e.g.*, *Alex Sheshunoff Management Serv. v. Johnson,* 209 S.W.3d 644, 50 Tex. Sup. J. 44, 25 I.E.R. Cases 481 (Tex. Sup. Ct. Oct. 20, 2006) (training or disclosure of confidential information could provide additional necessary consideration); *Socko v. Mid-Atlantic Systems of CPA, Inc.*, 126 A.3d 1266, 40 I.E.R. Cases 1568 (Pa. Sup. Ct. Nov. 18, 2015) (''In the context of requiring an employee to agree to a restrictive covenant mid-employment, however, such a restraint on trade will be enforceable only if new and valuable consideration, beyond mere continued employment, is provided and is sufficient to support the restrictive clause.'') These factors thus also become issues that one must consider in valuing the agreements assigned or to be assigned.

Employment Agreements as Assets

Of course, it is also important for transactional attorneys to specify expressly in the transactional documents themselves that such employment agreements are among the assets being transferred. This was highlighted in a district court case in Washington, D.C., decided only two days after *Symphony Diagnostic Servs.* *See Hedgeye Risk Mgmt., LLC v. Heldman,* (D.D.C. July 8, 2016) (denying enforcement of covenant, holding that ''[t]he text and structure of the APA answer that question [*i.e.* whether the agreement were conveyed], and they belie any claim that PRG's employment contracts were among the 'assets' conveyed in the APA).

The court rejected plaintiff's argument that the overall purpose of the asset purchase agreement precluded the need for an express reference to the agreements as assigned assets: Hedgeye's only remaining argument—and, in truth, its primary argument—is that ''the entire point of the sale between PR[G] and Hedgeye was that Hedgeye was desirous of obtaining PRG's talent.'' Dkt. 3-1 at 8. That is, Hedgeye argues that its goal in acquiring PRG (and thus in executing the APA) was to acquire the services of PRG's employees, and particularly Heldman. *See id.* (arguing that the APA provision requiring Hedgeye to pay Heldman's bonus ''evidenc[es] Heldman's clear value to the transaction'').

It is not hard for the Court to believe that Hedgeye desired to hire PRG's employees, nor that it wanted to hire Heldman in particular. But it is hard to read the APA to achieve that result itself—not in light of the APA's express statement that Hedgeye may ''*offer* employment'' to all PRG employees. *See* Dkt. 1-2 at 15 (APA at 14) (emphasis added).

Thus, the *Hedgeye* Court offered a lesson at the asset sale stage that care be taken to be clear, just as *Symphony Diagnostic Servs.* provided lessons on considerations for drafting the post-employment restrictions originally.

Conclusion

Whether seeking to support or challenge assigned agreements or just trying to determine the value of restrictive covenant agreements to be assigned, cases like *Symphony Diagnostic Servs.* merit continued attention, especially as they emerge in additional jurisdictions. The ability to determine what rights may exist for an acquired business to protect from direct competition by its former employees may be vitally important in determining the value to be paid for the assets of the business, whether to proceed with the acquisition at all, and the options that are presented in its aftermath.